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FEDERAL COMMUNICATIONS COMMISSION
OFFICE OF THE SECRETARY

Ms. Magalie Roman Salas
Secretary
Federal Communications Commission
445 12th Street S.W.
Washington, DC 20554

Ex Parte Presentation

Re: In the Matter of Joint Application by SBC et al. for Provision of In-region
InterLATA Service in Kansas and Oklahoma: CC Docket No. 00-217

Dear Ms. Salas:

This letter responds to SBC's reply comments concerning its rates for unbundled network elements ("UNEs"). It is submitted at the request of the Commission staff. Although the UNE pricing issues were contested by AT&T in both Oklahoma and Kansas prior to the filing of SBC's joint application, SBC barely addressed them in its opening comments. *See* SBC Comments at 86-87.

Instead, SBC waited until its reply to set forth its position. Its principal argument is that the Commission should not independently determine whether SBC's UNE rates in Kansas and Oklahoma each comport with TELRIC. SBC Reply at 3-7. Alternatively, SBC claims that the differences in UNE rates among the states are attributable to cost differences (*id.* at 7-11), and that the Kansas Corporation Commission (KCC) and Oklahoma Corporation Commission (OCC) each followed TELRIC methodology. *Id.* at 11-23.

None of SBC's post-hoc rationalizations has merit. Indeed, SBC's reply actually provides further evidence that its UNE rates are not cost-based. Although SBC's Oklahoma UNE rates are substantially higher than its Kansas rates for the same UNEs, SBC's own cost studies establish that SBC's *costs* in the two states are largely the same and, indeed, that in some instances, costs are significantly lower in Oklahoma than in Kansas. *See* Part II, *infra*. There is thus no question that SBC has failed to prove that it has fully implemented the pricing requirements of sections 251(c)(3) and 252(d) and the competitive checklist. § 271(c)(2)(B)(ii).

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I. The Commission Should Independently Determine Whether SBC's UNE Prices Are Cost-Based.

SBC's threshold argument attacks a straw man. SBC claims that AT&T and DOJ have asked the Commission to abandon its decision not to use section 271 proceedings to conduct a "de novo review of state pricing determinations" and to "adjust rates to conform with TELRIC." SBC Reply at 3-4 (quoting *AT&T Corp. v. FCC*, 220 F.3d 607, 615 (D.C. Cir. 2000)). Neither did so. Instead, both DOJ and AT&T pointed to concrete evidence "that the prices in Kansas and Oklahoma were not determined in accordance with the Commission's methodological requirements." DOJ Eval. at 2; see, e.g., AT&T Comments at 14 ("The [Oklahoma] ALJ's explanation constitutes a blatant methodological error of the type described by this Commission in the *Ameritech Michigan Order* and the *BA-New York Order* as requiring independent scrutiny and reversal"). It is well-established that a state commission's violation of basic TELRIC principles is grounds for rejecting a section 271 application.

SBC's related assertion that the comments merely reflect complaints about "isolated factual findings" by state commissions is absurd. SBC Reply at 4 (quoting *BA-New York Order*, 15 FCC Rcd at 4084, ¶ 244). AT&T demonstrated that both the KCC and OCC violated "basic TELRIC principles," and reached an "end-result" far outside the range that TELRIC principles would have produced. See, e.g., AT&T Comments at 8-18 (OCC's basic TELRIC violations led to recurring rates in Oklahoma from "35% to 200%" higher than Kansas); *id.* at 18-21 (KCC's basic TELRIC violations led to non-recurring rates "two, three or four or more times higher" than in Texas).

SBC again mischaracterizes the core issues when it claims that the sole basis for the commenters' assertion that the Oklahoma and Kansas rates are not cost-based is that they "are somewhat higher than the rates in Texas." SBC Reply at 5; see *id.* at 5-6. Both the OCC and KCC each committed fundamental methodological errors in setting UNE rates. That is the checklist violation. Comparisons to rates set in other SBC states serves simply as one way of illustrating the practical significance of the violation.

AT&T demonstrated that the OCC failed to follow TELRIC in setting recurring UNE rates; the OCC adopted negotiated rates that were not cost-based, and justified them after-the-fact with rationalizations that conflict with TELRIC. The crucial point – ignored by SBC – is that AT&T then compared those rates not to Texas but to *Kansas*, which rejected many of the methodological arguments that the OCC endorsed, and as a result reached radically different results. Because "[t]he methodological divergence between the two Commissions therefore could not be more stark," AT&T argued that the Commission "cannot reasonably hold that both of these Commissions adopted TELRIC." AT&T Comments at 17. Nowhere does SBC confront this critical problem.

Finally, SBC claims that both DOJ and AT&T have urged the Commission "to set rates on its own." SBC Reply at 7. Neither has done so. Indeed, at the pages cited by SBC, AT&T set forth a detailed statutory and policy analysis concerning the Commission's duty to make an independent determination whether rates are cost-based, to which SBC has no answer. SBC thus fails to advance even a colorable reason for this Commission not to "determin[e],"

independently, whether SBC has fully implemented its duty to provide CLECs with cost-based UNE rates in Kansas and Oklahoma. § 271(d)(3).

II. The Enormous Disparity Between SBC's Kansas And Oklahoma Rates Cannot Be Explained By Cost Differences.

Notwithstanding that SBC's costs of providing most UNEs in Oklahoma and Kansas are concededly virtually the same, SBC charges much more – indeed, up to *twice* as much – for its Oklahoma UNEs. Plainly, the recurring rates in Kansas and Oklahoma cannot *both* be cost-based – at least not if the requirement of cost-based prices is to retain any substance at all.

The record on this issue is clear and undeniable. SBC used the same cost models in Oklahoma and Kansas and, for all relevant intents and purposes, estimated the same costs in the two states. See Baranowski/Flappan Decl. ¶¶ 16, 69 & Attachments 2, 3 (attached to AT&T comments); Ries/B. Smith Reply Aff. ¶¶ 7, 33, 48 (attached to SBC Reply Comments). The Commission's original *Local Competition Order* and a recent National Exchange Carrier Association study likewise estimate very similar costs for the two states. See Baranowski/Flappan Decl. at ¶¶ 16, 69. The reason for the enormous disparity in the two states' rates for elements that have the same costs is equally clear and undeniable. Although the Kansas Commission applied a forward-looking TELRIC methodology in evaluating the recurring cost evidence, the Oklahoma Commission did not. Instead, the Oklahoma Commission simply rubber-stamped negotiated rates that were not supported by any methodology or any cost study.

Faced with this stark reality, SBC now attempts to run away from its own evidence that the costs in the two states are virtually identical (and that, with respect to some elements, the costs in Kansas are actually *higher* than in Oklahoma). Lacking any basis to justify the Kansas/Oklahoma rate differences, SBC throws Texas into the mix. Rate differences between Texas, on the one hand, and Kansas and Oklahoma, on the other hand, are explained, SBC claims, by differences in the line density characteristics among the states' rate zones.

Even if that were true,¹ it could not explain the relevant – and quite extraordinary – differences between the Kansas and Oklahoma recurring rates. SBC does not even seriously attempt to justify those differences, including Oklahoma loop rates that are as much as 50% higher than Kansas loop rates and Oklahoma switching and transport rates that are as much as twice the comparable Kansas rates. Indeed, in its zeal to establish cost differences with Texas, SBC directly confirms that to the extent any material cost differences exist between Oklahoma

¹ Because SBC provides the underlying Texas data for a single element (2 wire 8 db loops) for a single zone, there is obviously no basis for any general conclusion that all of the substantial differences between UNE rates in Texas and those in Oklahoma and Kansas are explained by legitimate cost differences. Differences in rate zone definitions certainly cannot fully explain the rate differences, because the fill factor, depreciation, non-recurring cost and other fundamental TELRIC violations that AT&T and other commenters have identified artificially inflate rates in all zones and are unaffected by zone definitions or characteristics. Indeed, even with respect to the 2 wire 8 db loops, SBC does not provide the full cost runs that would establish such cost differences, but merely compares selected characteristics of the loops in each of the three state's Zone 1.

and Kansas, it is *Kansas* that is more costly to serve. Thus, SBC stresses that “[i]t is no surprise [given differences in line density] . . . that loop costs are greater in Kansas than in Oklahoma and Texas, especially in the rural zone.” SBC Reply at 9. But if the rural loop costs are higher in Kansas than in Oklahoma, it should come as a great surprise – and as a reason for denying the Joint Application – that SBC’s rural zone loop *rates* are much higher in Oklahoma than in Kansas. SBC told the state commissions that rural zone loop costs are 50% higher in Kansas than in Oklahoma, *see* Baranowski/Flappan Aff., Attachment 2, yet the rates approved by the two state commissions exhibit precisely the opposite relationship – the rates approved by the Oklahoma Commission are 50 percent higher than the rates approved by the Kansas commission, *see id.* Attachment 3. The same incongruity between costs and rates exists with respect to other network elements. For each such element, SBC told the state commissions that costs in Kansas and Oklahoma were about the same (estimating that costs are slightly higher for some elements in Kansas and slightly higher for other elements in Oklahoma), and yet for almost every element, the Oklahoma commission approved much higher rates than the Kansas Commission. *See* Baranowski/Flappan Aff., Attachments 2, 3 (summarized in Attachment 1 to this letter).

SBC’s only explanation of this clear mismatch between rates and costs is to note that the Kansas Commission rejected SBC’s distance band, fill factor and depreciation assumptions as not forward-looking, and the Oklahoma Commission did not. SBC Reply at 9. But that is precisely the point. The rate disparities between Oklahoma and Kansas exist not because of any legitimate cost differences, but because the Kansas Commission, unlike its Oklahoma counterpart, insisted that the SBC cost models reflect forward-looking, cost-based assumptions. If, as SBC claims, *that* kind of difference is defensible and does not establish “varying commitments to TELRIC,” SBC Reply at 10, then the forward-looking cost requirement is truly nothing but an empty shell.

Recognizing as much, SBC attempts to fabricate a distinction between “methodologies,” which it concedes must be forward-looking, and “inputs,” which it apparently contends are entirely within the states’ discretion without regard to the checklist requirements. The argument is both pointless and wrong. It is pointless because there plainly was a difference in methodologies here. The KCC applied a forward-looking methodology, and the OCC, which endorsed arbitrary negotiated rates, applied no methodology at all. And it is wrong, because forward-looking rates can be established only if a state commission insists on cost studies that employ forward-looking assumptions – regardless whether those assumptions are hard-wired into a cost model or designed as user-adjustable inputs. Indeed, it is now universally recognized that *most* of the important assumptions that determine whether or not rates are forward-looking occur through user-adjustable inputs such as fill factors, depreciation, cost of capital and switch prices. That is why the Commission conducted nearly two years of proceedings to establish forward-looking inputs for its universal service cost model, and that is why the parties to interconnection arbitrations routinely stipulate to the use of a particular cost model and litigate only the inputs. In short, SBC has no explanation for the enormous differences between its Oklahoma and Kansas rates, and the Joint Application should be denied on that ground alone.

III. The Arbitrary Oklahoma Rates Plainly Violate Core TELRIC Principles.

Even if SBC could wish away the undisputed Kansas/Oklahoma cost and rate relationships that so starkly demonstrate that SBC's Oklahoma recurring rates are not cost-based, it could not meet its burden to demonstrate that those Oklahoma rates comply with checklist item two. The Oklahoma recurring rates are not the product of applying TELRIC or any other cost standard. Rather, they are the product of a deal between one facilities-based CLEC (with interests that diverge from most UNE purchasers), the OCC Staff and SBC. In the absence of cost evidence that supports the negotiated rates, there is no possible basis for a finding that the rates are cost-based.

For the first time on reply, SBC attempts to identify such evidence, claiming that testimony submitted by the OCC Staff's consultant, Liberty Consulting Group ("Liberty"), and by Cox Oklahoma Telecom, Inc. ("Cox") support the conclusion that SBC's UNE rates in Oklahoma are cost-based. SBC Reply at 18-20. These contentions are entirely baseless.

Prior to the hearing, the OCC Staff had retained Liberty to review the cost studies filed by SBC and AT&T and to identify areas where adjustments should be made to produce UNE rates in compliance with federal and Oklahoma law. Baranowski/Flappan Decl. ¶ 67. Liberty requested AT&T to rerun the SBC cost studies with the inputs and assumptions that Liberty believed were appropriate for a properly conducted cost study in compliance with the provisions of the 1996 Act and the Oklahoma costing rule (OAC Section 165.55). Baranowski/Flappan Decl. ¶ 68. AT&T reran the SBC cost studies pursuant to the directives and instructions of Liberty Consulting. As reflected in Attachment 2 to this letter (and Attachment 7 of the Baranowski/Flappan Declaration), the UNE rates approved by the ALJ and subsequently adopted by the OCC substantially exceed the rates that, Liberty believed were cost-based.²

The notion that Cox's evidence (the testimony of Francis R. Collins) establishes that SBC's UNE rates are cost-based is equally preposterous. Prior to the filing of the settlement rates ultimately approved by the OCC, Dr. Collins testified that he was unable to complete either of the two phases of his TELRIC analysis. *OCC ALJ Order* at 109. In particular, "he was unable to perform the independent studies necessary to establish the appropriate values for all TELRIC model inputs," and instead had to use SBC input values, a number of which he believed to be "questionable" and "biased upwards." *Id.* Due to time constraints, Dr. Collins was able to complete the second phase of his study only with respect to 2-wire local loop costs, which showed SBC's proposed loop costs to be overstated by 42-48%. *Id.* at 110. Dr. Collins did not file a cost study with respect to the settlement rates, but merely offered oral testimony urging the OCC to approve the settlement rates because they fell between the rates proposed by SBC and AT&T. *Id.*

² As noted in AT&T's comments, the OCC Staff counsel announced at the hearing that the Staff would not introduce Liberty's testimony. *OCC ALJ Order* at 157. Subsequently, Staff counsel announced that he was asked by his client to move for introduction of the Liberty testimony. *Id.* The ALJ denied the motion. The hearings concluded and the ALJ notified the parties by telephone that he was recommending approval of the Cox/Staff stipulation and directed the parties to prepare a draft written recommendation. On April 14, 1998, as the draft was being prepared, the OCC ordered the ALJ to reopen the record for the submission of the Liberty testimony and exhibits.

Accordingly, SBC must defend the Oklahoma rates, if at all, on its *post hoc* “split the baby” theory that the wildly different AT&T and SBC rate proposals established “a range of reasonableness,” and that *any* rates within that range are appropriately cost-based. But that theory necessarily fails if – as is clearly the case – SBC’s rates proposals were not the product of forward-looking analysis.

As AT&T described in its comments, SBC’s use of its current network and processes as both the starting and end points of its calculation of costs directly conflicts with the Commission’s clear mandate that TELRIC methodology rejects the “recovery of costs other than forward-looking economic costs, . . . including . . . embedded or accounting costs.” *Local Competition Order* ¶ 621. As such, SBC’s proposed rates could not properly serve as an upper boundary for TELRIC-based rates.³ AT&T identified a host of areas in which SBC’s cost estimates reflected assumptions that violate core forward-looking cost principles in ways that grossly inflated its rate proposals.⁴ As the following examples make clear, SBC largely ignores these fatal errors.

³ The ALJ’s finding that the AT&T’s proposed rates could serve only as a “lower boundary” for his rate analysis was also plainly in error. The ALJ’s explanation for rejecting many of AT&T’s proposed UNE rates -- that they reflected more efficient facilities or processes than SBC used in 1998 -- flatly conflicts with the Commission’s requirement that UNE prices reflect “the most efficient telecommunications technology currently available and the lowest cost network configuration.” 47 C.F.R. §51.505(b)(1). Rates developed consistent with the TELRIC standard do not establish a lower boundary for TELRIC-based rates -- they are TELRIC-based rates.

⁴ SBC asserts that “AT&T never objected to SWBT’s rates in the Oklahoma 271 proceeding.” SBC Reply at 17; Jones Reply Aff. ¶ 32. This baseless assertion underscores the degree to which SBC is willing to misstate the record in an effort to persuade this Commission not to look at the merits of the UNE pricing issues in this case. The UNE rates at issue here were approved by the OCC following proceedings before an ALJ in which AT&T vigorously objected to SBC’s cost studies and the settlement rates, which the OCC ultimately approved. Cause Nos. PUD 97-213 and 97-442, OCC Order No. 424864 dated July 17, 1998. In the state 271 proceeding that followed, AT&T again argued that SBC’s UNE rates were not cost-based. The ALJ in the 271 docket rejected AT&T’s arguments, finding that they were moot in light of the OCC’s ruling in the cost proceeding. Cause No. PUD 97-560, ALJ Report and Recommendations dated January 28, 1999, Interim Report at 7. The OCC rejected AT&T’s appeal with respect to whether SBC’s UNE rates were cost-based. Cause No. PUD 97-560, OCC Order No. 434494, dated August 18, 1999, at 4, 8-9. With respect to checklist items (such as UNE pricing) as to which the OCC had determined SBC was in compliance, the OCC limited further filings to evidence showing changed circumstances occurring since 1998 and demonstrating that SBC was no longer in compliance. *Id.* at 10. Consistent with this restriction, when SBC reopened its 271 application in June 2000, AT&T argued that the UNE rates in the O2A (a new circumstance) were not cost-based. The OCC rejected “AT&T’s claim that the O2A incorporates non-cost-based rates.” Cause No. PUD 97-560. Order No. 445180, dated September 28, 2000 at 167.

Fill Factors. The OCC ALJ labeled fill factor as “the single most influential input to loop investment.” *OCC ALJ Report* at 161. In its Oklahoma cost study, SBC used a fill factor for distribution cable based on its current fill factor. Baranowski/Flappan Decl. ¶ 40.⁵ Thus, SBC assumed that its distribution plant is less than one-third full and is expected to remain at that level forever. An efficient firm operating in a competitive environment would not maintain such a high level of spare capacity, and SBC does not even attempt in its Reply to argue otherwise. *Id.* AT&T assumed a fill factor of 50%. *Id.* Liberty Consulting Group, on behalf of the OCC Staff, recommended distribution fill factors of 44-60%. *Id.* The KCC directed SWBT to use a 53% fill. *KCC Inputs Order* at A-27 (“In determining the fill factor, future utilization of the facilities should be considered”). And the FCC’s Synthesis Costing Model uses distribution fills ranging from 50% to 75%. *Id.*⁶

The Oklahoma ALJ criticized AT&T’s forward-looking approach, holding that “the Act requires SWBT to unbundle its existing network, not some superior quality network. . . [citations omitted] A reflection of fill well beyond what is currently available and used by SWBT to provide retail services essentially asks SWBT to provide superior quality facilities to AT&T.” *OCC ALJ Report* at 161. Thus, it could not be clearer that the ALJ’s endorsement of the negotiated loop rates was the product of a fundamental misunderstanding of core forward-looking costing principles, and not, as SBC would have it, a determination that those rates were within a zone of reasonableness established by two appropriately cost-based proposals. *See, e.g., Local Competition Order* ¶ 682 (fill factors should reflect “the proportion of a facility that *will be filled*”) (emphasis added).

The same pattern was repeated with respect to the fill factor for dedicated transport. SBC used its “actual” current fill factors for terminal equipment for fiber. “AT&T, by contrast, used significantly higher “objective” fill factors (also provided by SWBT), which reflects the long term utilization that engineers design the network to achieve”. Baranowski/Flappan Decl. ¶ 43.

⁵ As a further illustration of the lengths to which SBC has gone to divert attention from the merits of the UNE pricing issue, SBC witnesses Ries and Smith begin their reply affidavit (at footnote 1) by attacking the background of Robert P. Flappan, one of AT&T’s witnesses. Ries and Smith falsely claim that Mr. Flappan misrepresented his background before the OCC and then changed the description of his background before the KCC. Contrary to the Ries/Smith claims, Mr. Flappan’s description of his educational and work background before the OCC and the KCC were essentially identical and made no representation that he had entered a degree program in economics. The fact that the *OCC ALJ Report* also erred with respect to Mr. Flappan’s background is due entirely to the fact that the OCC ALJ adopted wholesale SBC’s biased summary of the cross-examination of witnesses.

⁶ SBC admits that its fill factors reflect “what is actually experienced in SWBT’s network today.” Ries/Smith Aff. ¶ 54. *Compare* Tenth Report and Order, Federal-State Joint Board on Universal Service, *et al.*, 14 FCC Rcd 20156 (1999) (“The administrative fill factors are determined per engineering standards and density zone conditions. These factors are independent of an individual company’s experience and measured effective fill factors. The administrative fill factors would be the same for every efficient competitive firm”).

Again, Liberty agreed with AT&T. Direct Testimony of Paul P. Hlavac (Baranowski/ Flappan Decl. Attachment 4) at 14 (“Staff does not believe that actual fills are appropriate to use in a TELRIC cost study unless SWBT can demonstrate that those actual fills are optimal, that is, the most appropriate in a modern, forward-looking, efficient network”). Again, the ALJ agreed with SBC. *OCC ALJ Report* at 165. And again, the KCC, when presented with the identical issue, held that SBC’s objective engineering fill factor “better reflects forward-looking conditions than actual fill and is therefore appropriate for use in a TELRIC cost study.” *KCC Inputs Order* at A-88–89.

Depreciation Lives. With respect to plant lives, AT&T’s cost studies in Oklahoma and Kansas used the Commission’s projection lives, which were also the projection lives prescribed by the OCC and KCC at the time of those studies. Baranowski/Flappan Decl. ¶ 25. By contrast, SBC used lives it generally uses for financial reporting purposes. For the key accounts (digital switching, digital circuit and outside plant), the lives used by SBC are much shorter than those prescribed by the Commission, resulting in significantly higher costs and UNE rates. *Id.*

The OCC ALJ recognized that the plant life issue was highly significant but chose not to tackle it. *OCC ALJ Report* at 167 (“The matter of depreciation lives is of relevance and material but given the ranges, is amply addressed with the stipulation results which reduce recurring costs” from the SBC proposals). By contrast, the KCC – again taking exactly the opposite tack on a fundamental methodological issue -- rejected SWBT’s use of shorter plant lives: “the FCC-authorized (and state-approved) SWBT depreciation rates for Kansas reflect forward-looking considerations and should be used in the TELRIC cost studies.” *KCC Inputs Order* at A-43 – 44.

SBC now attempts to defend the Oklahoma rates by arguing that the Commission’s depreciation lives are *not* forward-looking. Ries/B. Smith Reply Aff. ¶ 61. Both the Commission and numerous state commissions have held otherwise. Over a decade ago the Commission directed its staff to put less emphasis on historic data in estimating productive lives, and to pay “closer attention to company plans, technological developments and other future-oriented analyses.”⁷ More recently, the Commission reaffirmed its forward-looking orientation in connection with the simplification of its depreciation prescription practices. The Commission prescribed a range of projection lives which could be selected by carriers for prescription on a streamlined basis and stated that these ranges were based upon “statistical studies of the most recently prescribed factors. These statistical studies required detailed analyses of each carrier’s most recent plant retirement patterns, the carriers’ plans, and the current technological developments and trends.”⁸ As such, this streamlined prescription practice assures the development of projection lives that allow forward-looking capital recovery. As a

⁷ Report on Telephone Industry Depreciation, Tax and Capital/Expense Policy, Accounting and Audits Division, Federal Communications Commission, April 15, 1987, p. 8.

⁸ 1998 Biennial Regulatory Review – Review of Depreciation Requirements for Incumbent Local Exchange Carriers, et al., CC Docket No. 98-137 & ASD 98-91, Report and Order, FCC 99-397 (released December 30, 1999); Simplification of the Depreciation Prescription Process, CC Docket No. 92-296, Third Report and Order, FCC 95-181, released May 4, 1995, ¶ 11.

result, numerous state commissions have used FCC-prescribed projection lives for use in TELRIC calculations.⁹

Non-recurring charges. “With respect to ordering and preordering, SWBT’s cost studies assumed a *manual* process where the new entrant faxes or phones in the order and the SWBT service representative enters all of the data into the computer”. Baranowski/Flappan Decl. ¶ 46. This assumption directly conflicts with SBC’s obligation under the 1996 Act to provide electronic interfaces for ordering and preordering and the requirement that efficient technology and processes be used under the TELRIC standard. Consistent with his own backward-looking focus, the OCC ALJ sided with SWBT. Citing the fact that, as of 1998, electronic interfaces were not yet completely in place or in use, the ALJ found the assumption of electronic ordering and preordering to be “speculative.” *OCC ALJ Report* at 165 (“Based upon the current record, the ALJ concludes that manual UNE service order activity is the likely option”).

As the foregoing examples illustrate, the SBC cost studies repeatedly deviated from the forward-looking cost principles embodied in TELRIC, and the OCC endorsed the same backward-looking approach in approving the negotiated rates. On this record, there can be no serious claim that the Oklahoma rates fall within “a range of reasonableness.” Those rates are grossly excessive and bear no relation to TELRIC rates.

IV. The Kansas Non-Recurring Charges Are Not Cost-Based.

As DOJ and AT&T demonstrated in their earlier comments, SBC’s non-recurring charges (“NRCs”) for UNEs in Kansas do not comply with TELRIC. In its 1999 *Reconsideration Order* the KCC recognized that SBC’s “proposed NRCs are in most cases overstated.” *KCC Recon. Order* at 26. The KCC ordered SBC to “rerun NRC studies” and to “use a fall out rate of 5%,” to “assume electronic processing,” and to “assume a 100% Dedicated Inside Plant (DIP) and an 80% Dedicated Outside Plant (DOP) factor.” *Id.* at 27. The KCC’s orders confirm that SBC largely ignored these directives. *See KCC NRC Order* at 13 (“Staff notes that in spite of direct language in Commission orders, SWBT submitted a cost study based on fully manual processes”); *id.* at 27 (“The Commission specifically directed SWBT to use a fall out rate of 5 percent”); *id.* at 14 (“Beyond the electronic service order cost study, SWBT continues to make a variety of assumptions regarding fallout”); *id.* at 15 (“The Commission required the use of a 100 percent DIP factor in calculating non-recurring costs. According to staff, ‘it could find no evidence that SWBT complied with this provision of the Order on Reconsideration’”); *id.* at 35 (“SWBT should have complied with the Commission’s orders in this case”). Incredibly, given the KCC’s *Reconsideration Order* finding that the resubmission of cost studies was necessary

⁹ See, e.g., Texas PUC Docket 16189, et al., November 7, 1996; Massachusetts Docket DPU 96-73/74, 96-75, 96-80/81, 96-83, 96-94-Phase 4, December 4, 1996; New York PSC Docket 95-C-0657, 94-C-0095, 91-C-1174, April 1, 1997; West Virginia PSC Docket 96-1516-T-PC, April 21, 1997; Wyoming PSC Docket 70000-TF-96-319, 72000-TF-96-95, April 23, 1997; Delaware PSC Docket 96-324, April 29, 1997; Ohio PUC Docket 96-922-TP-UNC, June 19, 1997; Michigan PSC Docket U11280, July 14, 1997; Colorado PUC Docket 96S-331T, July 28, 1997; Maryland PSC Docket 8731 (Phase II), September 22, 1997; Louisiana PSC Docket 22022/22093-A, October 27, 1997.

because SBC's original proposals were "overstated," the prices set forth "in SWBT's re-submitted cost study are significantly *higher* than the prices submitted in SWBT's original cost studies." *Id.* at 41 (emphasis added).

Rather than remedy SBC's refusal to comply with clear and direct KCC orders by accepting AT&T's TELRIC-based proposals or ordering SBC to rerun its studies yet again, however, the KCC used the concededly unlawful SBC proposals to set permanent NRCs to be incorporated into all existing and future interconnection agreements. In some cases, the KCC accepted SBC's proposal as is. *See KCC NRC Order*, Attachment B at 10 n. 8. In other cases, the KCC left the NRCs unchanged from the 1999 *Final Order*, notwithstanding its *Reconsideration Order* finding that those rates were generally "overstated." *See id.* at 10 n. 1. And for the majority of important NRCs, the KCC employed an entirely arbitrary "split the baby" approach setting the NRC at the weighted average of the AT&T and SWBT proposals (2/3 AT&T and 1/3 SWBT). *See id.* at 10 n.2. The KCC did not even attempt to support these determinations as cost-based.

The KCC frankly conceded that its motivation for throwing up its hand in this fashion was its public commitment to support SBC's 271 application and its recognition that approval of that application would necessarily require final, approved NRCs (that SBC could then label "cost-based"). *See id.* at 24 ("the [KCC] agreed to support SWBT's [section 271] application premised, in part, on the expectation that final permanent prices for UNEs, including the non-recurring charge component, would be in place and available to CLECs").

SBC now complains that it did not ignore *all* of the KCC's forward-looking directives. SBC Reply at 14; Ries/B. Smith Joint Reply Aff. ¶¶ 65-66. Even if true, that hardly solves SBC's problem given that the directives it did ignore – including the fundamental forward-looking principle that costly and inefficient manual processes should *never* be assumed when more efficient electronic processes are possible – produced non-recurring charges that far exceed cost-based levels. *See KCC NRC Order* at 27 ("The Commission specifically directed SWBT to use a fall out rate of 5 percent because the fall out of business orders from automated processing procedures in a business environment will result in additional manual handling (employee time), ill will and customer complaints, and ultimately the loss of business. These results would not be tolerated in a competitive environment. . . . As a regulatory policy matter, it is important to adopt forward-looking least cost standards to avoid institutionalizing disincentives that have an anti-competitive effect Assumed high fall out rates reward imprudence and inefficiency; high fallout rates have the consequence of added cost for competitors as well as delays and poor service for customers").

Because of SBC's clearly erroneous manual processing, fallout and DIP/DOP assumptions, SBC's rate proposals were many times higher than AT&T's TELRIC-based proposals, and thus even weighting SBC's study at 1/3 had the effect of more than doubling the resulting rates above cost-based levels. Baranowski/Flappan Decl. ¶ 79. This is obvious when the Kansas NRCs are compared to SBC's NRCs in Texas where the Commission largely rejected SBC's unlawful NRC proposals. The differences between the two SBC states are enormous. Baranowski/Flappan Decl. ¶ 81. In Texas, the loop NRC is about \$15; in Kansas, the same NRC is over \$30. The NRC for a basic analog loop to port cross-connect is a little more than \$4 in

Texas, but over \$26 in Kansas. Again and again, the Kansas NRCs are two, three or four or more times higher than the NRCs for the same elements in Texas. *Id.*¹⁰

SBC points out that the differences seem smaller when the NRCs are “amortized” over two years. Regardless of how one looks at these charges – as the single charges that CLECs must pay or as twenty-four smaller monthly charges that add up to the same amount – the facts remain that potential competitors in Kansas must pay twice as much for loop NRCs and six times as much for cross-connect NRCs for no other reason than that the Kansas commission was in a hurry to endorse SBC’s 271 application. And there can not be any serious doubt that NRCs at these exorbitant levels (that greatly exceed SBC’s retail charges for new service) are truly competition-foreclosing barriers to entry.

* * * *

In sum, nothing in SBC’s Reply remotely cures SBC’s utter failure to demonstrate compliance with checklist item two. The Oklahoma recurring rates and the non-recurring rates in both states far exceed any legitimate notion of cost-based rates, and the Joint Application should therefore be denied.

Sincerely,



David L. Lawson

cc: Anna Gomez
Jordan Goldstein
Kyle Dixon
Deena Shetler
Rebecca Beynon
Dorothy Attwood
Glenn Reynolds

¹⁰ As the KCC recognized, “NRCs should not be expected to vary significantly across SWBT’s jurisdictions because the activities associated with the NRCs are expected to be very similar across these jurisdictions.” *KCC Recon. Order* at 26. “The labor rate and time it takes to perform the operations would not be expected to vary significantly. It is Staff’s understanding that SWBT has established a centralized CLEC service order center for processing service orders and inquiries.” *Id.* See also *KCC Final Order* at 32 (“variances between Kansas [NRC] prices and other states should be limited”); *KCC NRC Order* at 2 (“Prices should be similar for similarly defined elements, especially for those cost elements that use common resources with the five SWBT states: Texas, Missouri, Arkansas, Oklahoma and Kansas”); *id.* at 24 (“it can be appropriate to rely upon the examination by other state commissions facing similar facts and circumstances”).

Jane Jackson
Richard Lerner
Rhonda Lien
Aaron Goldschmidt
Kathy Farroba
John Stanley